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The Inventory and the Accountant

BY ROY C. BROWN

There has been much discussion during recent years as to what responsibility a public accountant should assume for the correctness of the inventory figure as shown by his report. Such discussions have in the main tended toward the academic aspect of the question. The following history of an actual inventory is offered as commentary on the practicability of actual, physical inventory-taking by a public accountant, and in some degree it outlines correct practice for inventory of materials on hand.

During the world war I was a supervisory accountant for a shipbuilding corporation engaged in building ships for the United States shipping board on a flat contract price, extras and changes subject to special authorization and approval.

The corporation had started off on the wrong foot through charging direct to individual hulls, whether laid down or to be laid down, all material ordered specifically for such hulls and charging to stock of material only material and supplies for general application as ordered from the storehouse on requisition. There came a time when the shipping board, comparing advances with percentage of progress, found that the corporation, on the face of the record, was over two million dollars ahead in advances as compared with fixed and current assets and completed ships delivered and ships on the shipways.

The storekeeper maintained that he had neither the force nor the knowledge of special materials to take an inventory of anything other than what was under his immediate jurisdiction in the main storehouse. A joint audit of the books of the corporation by auditors representing the shipping board and public accountants representing the corporation seemed likely, and the question of a true and itemized inventory of all unapplied materials became vital. In the circumstances, I undertook to take such an inventory. The programme and procedure were as follows:

First, a supply of inventory cards was ordered, each one providing at the top for description of the item, class (the corporation had a material classification somewhat similar to the standard classification of the American Association of Railway Storekeepers) and location. Below were columns for count, unit, price

per unit and extension. Cards were numbered serially, beginning at one and running straight through to the final number.

Numbers were assigned to the storehouse, tool house under the shipways (where quantities of unapplied tool steel were stored), smith shop, machine shop, mold loft, sub-storehouses along the outfitting slip and in the yards, lumber yard, steel yard and machinery yard (where the main engines, boilers, etc. were stored) and in these places the space was blocked off into sections and numbered by painted signs hung on walls, nailed up or erected on posts.

From the time-keeping, time-checking and main offices I organized fourteen inventory parties of two men each, one to count items and mark, with a dot of red lead from a marking pot, each item, bin or container in which items were stored, and the other man to fill in the cards. I had assigned to each party, through the coöperation of the superintendent and the storekeeper, a man particularly familiar with the materials to be inventoried. These assignments were made daily, according to the requirements of the particular count in prospect, and the materials were thus identified. These special representatives also verified the count after the work became active.

For more than a week I held two-hour daily drills of the inventory parties selected from the clerical forces, instructing them how to fill in cards properly. I emphasized the importance of accurately noting location and of showing sizes and shapes of all such objects as bolts, nuts and steel and iron bars, and the structural shapes, sizes and gauge of plates. The crews were instructed to note tracing references as painted on fabricated steel, the character of lumber, the shop order numbers of partly manufactured material, the maker's plate reference, including serial numbers, wherever shown on boilers, engines and other machinery, etc. Vouchers for materials were exhibited to all, in order that each member of the inventory crew might have an idea of how materials were described coming from machinery and supply houses, lumber companies, etc.

On the appointed first of the month the inventory crew was assembled, and a supply of inventory cards was issued to each party of two, who were charged with the serial numbers of cards issued and notified that at the close of the day's work they must account for all cards so charged. The work was then commenced as arranged.

At the completion of each day's work, the completed cards were taken up and credit was given. The cards were placed in the hands of another crew of four men familiar with stores and stores accounting, by whom they were sorted, classified, priced and passed to the comptometer division to be extended, coming back to the pricing and classification crew for final inspection.

The field work consumed ten days, after which the field crew was disbanded and the members returned to their routine duties. On the morning of the twelfth day all cards were priced, extended, sorted according to classification and individual items within each classification. Two members of the crew that had priced and extended the cards were returned to routine duties. The cards were divided as nearly in half as possible, and three stenographers were assigned to each of the remaining two men from this crew. These men distributed the cards to the stenographers, received the completed sheets and reacquired the cards for final checking, after which, as a matter of extraordinary precaution, the inventory sheets were again checked as to calculations by the comptometer section. Additions were also made in this section, and the additions were independently verified by listing adding machines.

The completed inventory was typed, checked and ready for our archives and for the shipping board's representatives in about eighteen days. The total unapplied materials amounted to nearly two and three quarters of a million dollars in value, and I was told by representatives of the shipping board, particularly engineers who followed along later to check up unapplied cancellation material, that the completed work was something which no other yard had made available to them in a form so easily susceptible of quick verification.

It is possibly unnecessary to add that during the taking of the inventory described the usual precautions were exercised to insure inclusion of items issued on requisition or otherwise before they were counted and exclusion of items received after the first of the month. Estimates of indebtedness for materials on hand and counted in the inventory, for which invoices had not been received, were set up, and provision was made for listing materials known to be in transit, for which invoices had been received and delivery of which to the carriers had been completed by the vendors.

It seems evident that nearly any competent auditor with some knowledge of materials or goods, a capacity for organization and

leadership, all the force he needs and willing coöperation in technical matters from the client can take a full, complete and correct inventory which will meet every requirement.

But the point is raised that the necessary supply of competent casual workers to count and list at inventory periods, and subsist during the interim on such proceeds as they may be able to derive from other casual employment, is simply not available.

Discussion as to whether public accountants should superintend taking of inventories seems to me somewhat futile in the face of the fact that existing customs make such action impossible. Probably ninety per cent. of inventories are taken as of December 31st or June 30th. Inventories must be not only accurate but prompt in order to be of value. For every in-charge accountant at such times possibly ten extra men would be needed for inventory taking.

It is true that the inventory is generally the weak spot in a public accountant's report. He proves, or seeks to prove, every other item on the balance-sheet, but the inventory count he usually accepts from the client unless there is reason to suspect errors or fraud; for instance, if the gross profit shows violent fluctuations in comparison with prior periods or similar types of business.

The situation is unfortunate, but a solution of the problem is not impossible. I believe that as the desire for independent verification of inventories increases on the part of financial obligors, there will be more and more a trend toward keeping the same orderly accounts of stocks of material or merchandise as are kept for cash and receivables. Stocks will be classified, and going-inventory records will be installed and so accurately maintained as to be of real and convincing value, both in correctly reflecting the quantities on hand and in prevention of overstocking and the accumulation of dead stock.

It will then be possible to inventory goods by classes, at monthly intervals throughout the year, adjusting book inventories to actual count. Given a situation like this, the outcome might be the development of another profession closely allied to accountancy, with a personnel composed of mercantile and technical experts, devoting time throughout the year to inventories only and certifying with full knowledge and authority to the correctness of their findings.

This, however, is only one man's speculative point of view. In the meantime, I do not concede that public accountants generally

throw up their hands and confess entire ignorance of the inventory assets of their clients.

In numbers of cases I believe that accountants coming in after inventories have been taken do personally inventory items that run into money and can be counted rapidly, and that by adding issues or sales since inventory period and by deducting purchases they substantially verify the correctness of the client's count of these particular items, at least.

I also believe that when stocks are displayed, and not concealed by packaging which might conceivably be fraudulently marked or whose contents might be misrepresented, a competent auditor of a company with whose business he has a working familiarity will not be grossly misled as to the reasonable correctness of the inventory presented to him, particularly if the descriptions thereon are good and the pricing, extensions and footings are found to be free from error.

The great obstruction to the general usefulness of the public accountant through his investigations and verifications continues to be the reluctance of many clients to expend money for auditing and to face the facts which thorough auditing may develop. The impetus toward auditors' verification of inventories will certainly not come from clients, because of the increased cost, and for the auditor to urge that increased expenditure might be thought not entirely altruistic, to say the least.

Business ventures are restricted only to those possessing capital or credit. Too many business ventures are initiated by those who possess one or both, but lack knowledge and experience, and hence their transactions with public accountants are tinged with timidity. If the reverse were the case there might not be a greater percentage of outstanding merchants and manufacturers, but the general level would be immeasurably elevated, and the recommendations of accountants would be viewed with considerably less alarm and suspicion.

As far as sympathetic assistance, intelligent effort and discreet and friendly counsel may be exercised, I am satisfied that most certified public accountants, working both directly with their clients and with the public through their national and state associations, are assisting to the limit of their abilities in continual improvement of the economic structure.